

Report of the auditor-general to the Eastern Cape Provincial Legislature and the council on O.R. Tambo District Municipality

Report on the separate financial statements

Introduction

1. I have audited the separate financial statements of the O.R. Tambo District Municipality set out on pages ... to ..., which comprise the separate statement of financial position as at 30 June 2016, the separate statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the separate financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these separate financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2015 (Act No.1 of 2015) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of separate financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on these separate financial statements based on my audit. I conducted my audit in accordance with International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the separate financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the separate financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the separate financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the separate financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

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An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the separate financial statements.

5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Irregular expenditure

6. The municipality did not have adequate systems in place to identify and disclose all irregular expenditure incurred during the year as required by section 125(2)(d)(i) of the MFMA. The irregular expenditure disclosed in disclosure note 46.3 to the financial statements is understated in respect of amounts incurred during the year that were identified during the audit process of R10,4 million (2015: R168, 3 million). Due to the lack of systems and of sufficient appropriate audit evidence for all awards, it was impracticable to determine the full extent of the understatement of irregular expenditure disclosed at R2,1 billion (2015: R1,5 billion). Consequently, I was unable to determine whether any further adjustments were necessary to the irregular expenditure disclosure note.

Qualified opinion

7. In my opinion, except for the possible effects of the matter described in the basis for qualified opinion paragraphs, the separate financial statements present fairly, in all material respects, the financial position of the O.R. Tambo District Municipality as at 30 June 2016 and its financial performance and cash flows for the year then ended, in accordance with SA standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

8. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of corresponding figures

9. As disclosed in note 41 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of errors discovered during the year ended 30 June 2016 in the financial statements of the municipality at, and for the year ended, 30 June 2015.

Unauthorised expenditure

10. As disclosed in note 46.1 to the financial statements, unauthorised expenditure amounting to R18,3 million (2015: R201,5 million) was incurred by the municipality during the year. This was the result of the overspending of the total amount appropriated

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per vote for the Finance and Administration and Environmental Protection in the municipalities approved budget. In addition the municipality has accumulated a R2.2 billion balance at the end of the 2015/16 financial year which has not been investigated by council.

Fruitless and wasteful expenditure

11. As disclosed in note 46.2 to the financial statements, fruitless and wasteful expenditure amounting to R0,5 million (2015: R6,3 million) was incurred by the municipality during the year. In addition the municipality has accumulated a R24,2 million (2015: R23,8 million balance at the end of the 2015/16 financial year which has not been investigated by council.

Material losses

12. As disclosed in note 47.9 to the financial statements, material losses to the amount of R12,3 million were incurred as a result of water losses.

Additional matter

13. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited disclosure notes

14. In terms of section 125(2)(e) of the MFMA, the entity is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion thereon.

Report on other legal and regulatory requirements

15. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives of selected Key Performance Area (KPA) 1: Basic service delivery and infrastructure development presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

16. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information of the following selected KPA 1: Basic service delivery and infrastructure development presented on pages x to x in the annual performance report of the municipality for the year ended 30 June 2016.
17. I evaluated the usefulness of the reported performance information to determine

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whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned KPA 1: Basic service delivery and infrastructure development. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).

18. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

19. The material findings in respect of the selected KPA are as follows:

KPA 1: Service delivery and infrastructure development

Usefulness of reported performance information

Measurability of indicators and targets

20. Performance targets should be specific in clearly identifying the nature and required level of performance as required by the FMPPI. A total of 18% of the targets were not specific and measurable.

21. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 46% of the indicators were not verifiable.

22. This was because management did not adhere to the requirements of the FMPPI due to a lack of proper systems and processes.

Reliability of reported performance information

23. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. We were unable to obtain the information and explanations we considered necessary to satisfy ourselves as to the reliability of the reported performance information. This was due to limitations placed on the scope of our work due to the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information.

Additional matters

I draw attention to the following matters:

Achievement of planned targets

24. Refer to the annual performance report on pages x to x; x to x for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported

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performance information in paragraphs x; x; x of this report.

Compliance with legislation

25. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Strategic planning and performance

26. The municipality did not establish a performance management system, as required by section 38(a) of the MSA.
27. A framework for integrated development planning in the district was not adopted after the start of the elected term and did not consult with the local municipalities within its area, as required by section 27(1) of the MSA
28. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.

Annual financial statements, performance and annual report

29. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of commitments identified by the auditors in the submitted financial statements were subsequently corrected but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.

Expenditure management

30. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1) (d) of the MFMA.

Asset Management

31. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.

Human resource management

32. The municipality did not develop and adopt appropriate policies and procedures to monitor, measure and evaluate performance of staff in contravention of section 67(d) of the Municipal Systems Act.
33. The municipal manager and/ or senior managers directly accountable to the municipal manager did not sign performance agreements, as required by section 57(2)(a) of the Municipal Systems Act.

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Consequence management

34. Unauthorised, irregular and fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.

Procurement and contract management

35. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of by SCM regulation 17(a) and (c).
36. Invitations for competitive bidding were not always advertised for a required minimum period of days, in contravention of SCM regulation 22(1) and 22(2).
37. The preference point system was not applied in all procurement of goods and services above R30 000, as required by section 2(a) of the Preferential Procurement Policy Framework Act and SCM regulation 28(1)(a).
38. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
39. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, in contravention of section 116(2)(c) of the MFMA.
40. Awards were made to providers who were in the service of other state institutions, in contravention of MFMA 112(j) and SCM regulation 44. Similar awards were identified in the previous year and no effective steps were taken to prevent or combat the abuse of the SCM process, as required by SCM regulation 38(1).
41. Persons in service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality failed to disclose such interest, in contravention of SCM regulation 46(2)(e).

Internal control

42. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

43. Officials under the leadership's guidance and supervision continued to disregard laws and regulations governing procurement and supply chain management. A significant portion of irregular expenditure was detected during the audit process. The leadership

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has not followed or investigated these supply chain transgressions by officials. The lack of consequence management to ensure that appropriate action is taken against officials has a material impact on the effectiveness and the stability of the control environment. The leadership's inability to investigate and finalise unauthorised, irregular and fruitless and wasteful expenditure has a direct bearing on the promotion of accountability and sound governance within the district.

44. The municipality did not have sufficient monitoring controls to ensure the proper implementation of the overall process of planning, budgeting, implementation and reporting within the annual financial statements and annual performance report as well as over compliance with laws and regulations. Furthermore, disciplinary action was not always taken against officials who failed to adhere to the policies and procedures of the municipality or in instances where non-compliance with legislation was identified.
45. The institution did not have adequate action plans in place to address shortcomings in irregular expenditure, compliance and performance management that were identified during the internal and external audit processes.

Financial and performance management

46. Weekly and monthly reconciliations were not prepared for all financial items during the year. This is due to a lack of skills to execute basic accounting functions. This resulted in a high volume of manual reconciliation at year-end as part of the financial statement preparation process. Internal controls are not in place as a limited number of key officials within the finance unit are responsible for performing multiple incompatible functions (e.g. bank and cash, supply chain management and assets).
47. Internal controls are not in place as a limited number of key officials within the finance unit are responsible for performing multiple incompatible functions (e.g. bank and cash, supply chain management and assets). Certain reconciliations are prepared by senior finance officials and thus, does not allow for a higher level of review.
48. Systems and processes were not in place to monitor compliance with applicable laws and regulations. This is a repeat finding from the prior year. Resources available at the municipality were focused on addressing deficiencies in the annual financial statements; however, this focus did not extend to the compliance deficiencies
49. Document management practices were not appropriate for a district municipality and should be aligned to best practices to ensure that the storage and retrieval of documentation support decision making and internal and external audit processes.

Governance

50. The audit committee was not fully functional throughout the financial year and this had an impact on the effectiveness of the committee.

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51. Although a risk assessment framework is in place, management does not adequately monitor and report on progress of controls implemented, or respond to new risks that may arise. Therefore the risk management processes of the municipality were not considered to be adequate.

East London

30 November 2016



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SOUTH AFRICA

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